

*Los Angeles*

ECONOMIC ANALYSIS

National Economy

In fiscal year 2002-03 the national economy was characterized by slower than average growth, employment declines, increased productivity, low interest rates, high residential building activity, and increased deficit spending. Growth in the federal deficit was due in part to increased defense spending, including that required for the 2003 war in Iraq. Throughout the fiscal year, the economy was very slow to recover from a recession that had lasted from March through November of 2001.

Gross Domestic Product

Real gross domestic product (GDP)—the broadest measure of the nation's output of goods and services—increased 2.2 percent in 2002. While higher than the minuscule 0.5 percent increase of the 2001 recession year, growth was far below its ten-year average of 3.2 percent. Economic growth

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was also much lower than the average for periods coming out of post-World War II recessions. And while nonagricultural employment normally increases along with growth in real GDP, in 2002 U.S. nonagricultural employment declined 1.1 percent.

The economic recovery was so weak that in November 2002, one year after the recession ended, the Federal Reserve Board acted to stimulate the economy. They lowered the federal funds rate by 0.50 percent, to 1.25 percent. Throughout the remainder of the fiscal year, the rate stayed at or below 1.25 percent, the lowest it has been since recordkeeping began in 1955. Mortgage rates and other interest rates, both related to the federal funds rate, were also relatively low by historical standards in 2002 and 2003.

Real GDP by Sector

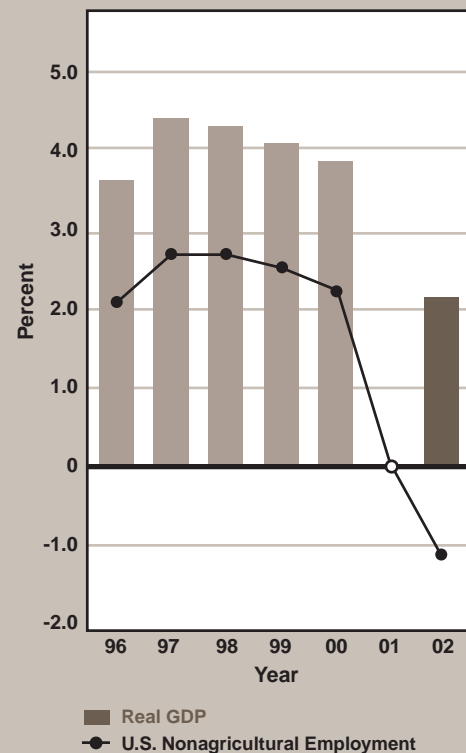
Consumer spending, which accounts for 70 percent of total GDP, was the main source of growth in 2002 and the first half of 2003. Real consumer spending rose by 3.4 percent in 2002 and by 2.9 percent from January through June 2003.

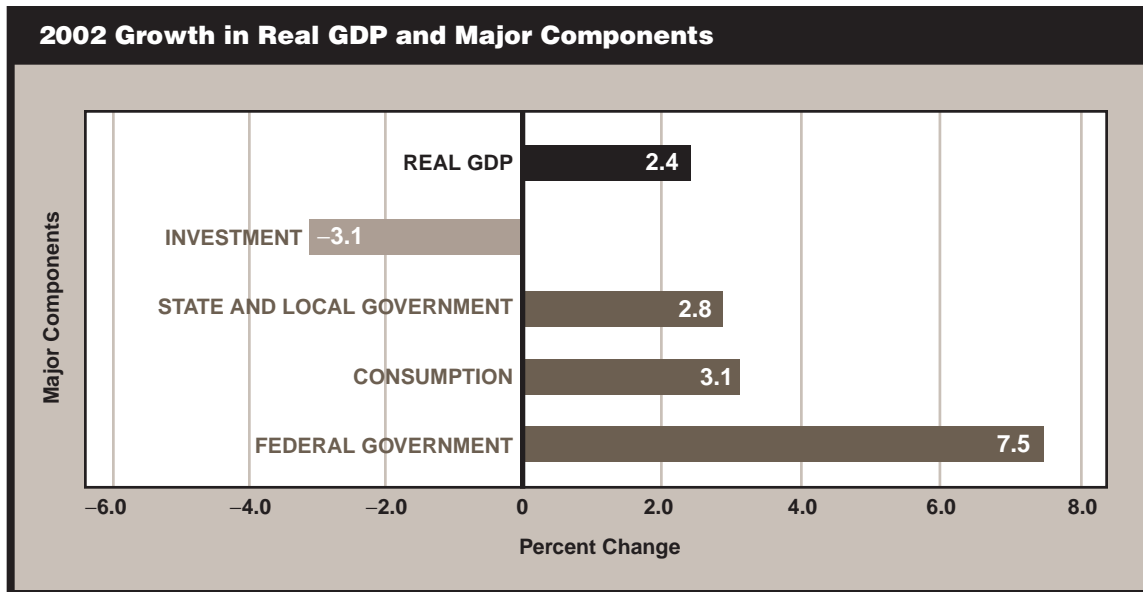
Real spending in fixed domestic investment, which made up 15 percent of total real GDP, declined 3.7 percent in 2002. Major components of fixed investment had vastly different growth rates. The largest component, equipment and software, declined 2.8 percent. Investment in nonresidential structures such as office buildings dropped 18.4 percent, in part due to higher office vacancy rates related to the recession. In contrast, residential investment increased by 4.9 percent as low interest rates encouraged home building activity.

Real exports of U.S. goods and services dropped 2.4 percent in 2002 as weak economic conditions lingered throughout most of the rest of the world. However, real imports of goods and services increased 3.3 percent as the U.S. economy improved. Together, the trends worsened the U.S. trade balance.

Real government spending on goods and services grew by 3.8 percent in 2002, an increase from growth of 2.8 percent in 2001. Weak revenues slowed growth in state and local government spending to 1.8 percent in 2002, the lowest growth rate since 1993.

Growth in Real GDP and U.S. Nonagricultural Employment, 1996–2002





However, federal government spending jumped in 2002. Real federal government spending increased 7.9 percent, the largest increase since 1967. Real national defense spending increased 8.9 percent, while real nondefense spending increased 6.2 percent. The federal spending increases were largely related to a defense buildup, the response to the September 11, 2001, terrorists attacks, and the war in Iraq that began in March 2003.

The Unemployment Rate and Consumer Prices

The U.S. unemployment rate averaged 5.8 percent in 2002, higher than pre-recession levels but close to the 1990s decade average of 5.8 percent. The 2002 unemployment rate was a decline from the highest unemployment rate of the 1990s, 7.5 percent, which occurred shortly after the 1990-1991 recession.

Lingering effects of the recession kept consumer prices down 2002 and early 2003.

The U.S. consumer price index rose just 2.2 percent in fiscal year 2002-03.

Federal Budget Deficit

With the recession, increased security spending following the September 11, 2001, terrorist attacks, and the war in Iraq, the federal budget deficit ballooned from \$158 billion in federal fiscal year 2001-02 (October through September) to \$375 billion in fiscal year 2002-03. According to the Congressional Budget Office, the deficit was largely caused by the recession's impacts on revenues coupled with revenue-reducing legislation intended to stimulate economic activity. Increased federal government spending, both newly legislated and recession related (such as increased expenditures for unemployment benefits), also contributed to the deficit.

The 2002-03 deficit was about 3.5 percent of GDP, a far higher percentage than the 2001-02 deficit, which was 1.5 percent of

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GDP. However, the 2002-03 deficit remains lower in relation to GDP than many of the budget deficits of the 1980s and early 1990s. The highest ratio of the past 20 years was fiscal year 1982-83, when the federal budget deficit was 6.0 percent of GDP.

California Economy

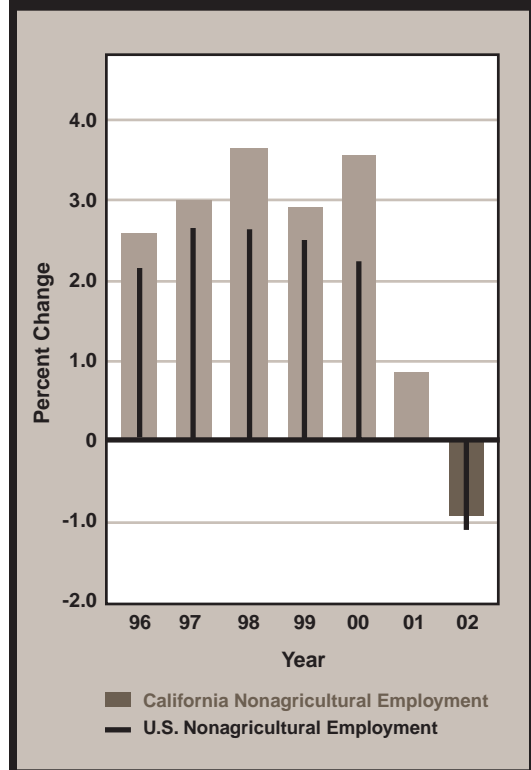
The 2002-03 California economy was very weak, suffering from the lingering effects of the recession much like the U.S. economy. California personal income increased slightly, but failed to keep pace with consumer prices.

The state's unemployment rate increased as the state lost nonfarm jobs for the first time since 1993.

Unprecedented Budget Shortfall

In 2002-03, California faced what the Legislative Analyst's Office called an unprecedented budget shortfall. It was brought about by the combined effects of increased spending and reduced revenues, in turn caused by the recession and declines in stock market prices. The LAO estimated that the budget shortfall was approximately one-third of the state General Fund.

Growth in California and U.S. Nonagricultural Employment, 1996-2002



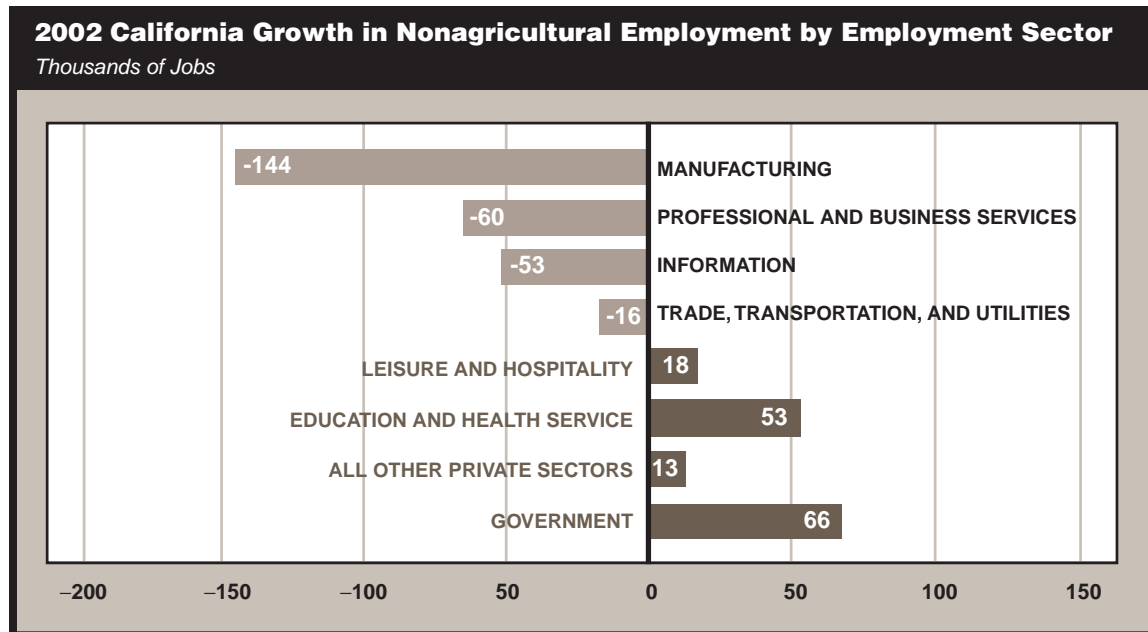
Employment and Income Growth

California lost 125,000 nonagricultural jobs in 2002, a decline of 0.9 percent and the first such decrease since 1993. The state's decline in payroll jobs was slightly less than the U.S. decline of 1.1 percent. California's 2002 average unemployment rate was 6.7 percent, 0.9 percent higher than the U.S. rate.

California personal income grew at the slowest rate since 1993. The state's personal income increased by 2.2 percent, close to the national (including California) increase of 2.3 percent and a decrease from 2001 growth of 2.7 percent.

Employment Sectors

Note: *This year the Employment Development Department began classifying employment data using the North American Industrial Classification System (NAICS). As a result, employment sector descriptions in this report differ from those used in previous reports, which relied on the Standard Industrial Classification (SIC) system.*



Manufacturing. The manufacturing sector, which employs 11 percent of workers on nonagricultural payrolls, had the largest jobs decline of any sector. A total of 144,000 manufacturing jobs were lost in 2002, an 8.1 percent decrease from 2001 and the largest decline in California manufacturing jobs in more than 50 years. Computer and electronic product makers accounted for the largest losses, with 13.5 percent of their workers dropping from the employment ranks.

Professional and Business Services. The professional and business services category is the state's third largest sector, employing 15 percent of California nonagricultural workers. After manufacturing, this sector suffered the next-largest employment loss, 60,000 jobs, a 2.8 percent decline from 2001. Computer systems design jobs decreased 14.7 percent, accounting for about half of the category's job losses.

Information. Information providers—publishing, motion pictures, broadcasting, telecommunications, and Internet services—lost 53,000 jobs in 2002, a 9.7 percent decline. There was a 27.9 percent decline in Internet service provider jobs alone. Information accounts for a relatively small share of state jobs, about 3 percent.

Trade, Transportation, and Utilities. This employment sector is the state's largest, accounting for about 19 percent of all non-farm jobs. In 2002, the sector lost about 16,000 services jobs, a 0.6 percent decrease.

Education and Health Services. Private education and health services are a relatively large jobs sector, accounting for about 10 percent of nonfarm employment. This sector had the largest increase of any private sector, adding 53,000 jobs, a gain of 3.6 percent.

Leisure and Hospitality. Leisure and hospitality industries, such as restaurants and hotels, employ about 10 percent of nonfarm Californian workers. Employment increased 1.3 percent in 2002, a gain of 18,000 jobs.

Other Sectors. The remaining private industry sectors—other services, financial activities, construction, natural resources, and mining—provide employment for 15 percent of California nonagricultural workers. Employment in this group increased about 0.6 percent, or 13,000 jobs.

Government. Government is California's second-largest employment sector, with 17 percent of all nonagricultural jobs. It grew more than any other sector in 2002—2.8 percent—adding 66,000 jobs. The bulk of the jobs, 55,000, were in local government (including school districts). The majority of the new jobs were for teachers.

Exports

The value of California-made exports to other countries declined 13.6 percent in 2002, reflecting a stagnant world economy and associated weak demand for technology products. Mexico remains California's largest export market. Of all California exports to major trading partners, exports to Mexico decreased the least, declining 1.6 percent.

Building Construction and Home Prices

The value of all building construction in California increased by 2.3 percent in 2002, as measured in inflation-adjusted 2002 dollars. A 12.7 percent increase in the value of residential construction more than offset a 15.5 percent decrease in nonresidential

construction. That decrease was primarily a drop in office building construction. Home building permits increased from 149,000 units in 2001 to 168,000 units in 2002. This was the largest number of permits issued since 1989.

Home prices increased rapidly in 2002 and early 2003, despite employment declines and weak income growth. This continued a trend of the last several years that is largely the result of relatively low home mortgage rates. In 2002, statewide median home prices rose 19 percent, with the median price of an existing single-family detached California home averaging \$318,000. In the recent past, Santa Clara County and the rest of the San Francisco Bay Area have led the increase in home prices. But in 2002, home prices generally increased more in other metropolitan areas. Statewide sales of single-family detached homes set a record in 2002, totaling 572,000, an increase of 13.5 percent from 2001.

Consumer Prices

Following the national trend, California consumer price increases slowed in 2002. Consumer prices for all urban consumers rose 2.4 percent in 2002, down from a 3.9 percent increase in 2001. At the national level, the consumer price index increased by 1.6 percent in 2002, down from 2.8 percent in 2001. Housing made up about one-third of all California consumer spending in 2002. Increasing real estate prices are likely keeping the growth rate of California's overall consumer price index above that of the nation as a whole.

Taxable Sales Activity

Transactions subject to sales and use tax totaled \$447.9 billion during the 2002-03 fiscal year, an increase of \$10.9 billion, or 2.5 percent, over 2001-02. Taxable sales grew in every quarter of the fiscal year, a reversal from 2001-02, which saw declines in every quarter. During the third quarter of 2002, taxable sales increased by 2.6 percent. In the next three quarters, taxable sales grew by 0.9 percent, 3.5 percent, and 3.1 percent respectively.

Measured in constant value dollars, taxable sales increased by 2.7 percent over 2001-02. The California Taxable Sales Deflator, an index that tracks price changes only for commodities subject to the sales and use tax, measured an overall deflation rate of 0.2 percent for the fiscal year. Price deflation occurred in three quarters of 2002-03, but there was inflation of 0.9 percent in the first quarter of 2003. The annual inflation rate shown by the Deflator annual inflation rate was less than that indicated by the California Consumer Price Index, which measured inflation at 2.7 percent.

California retail stores reported taxable receipts of \$309.4 billion for 2002-03, an increase of 4.7 percent over 2001-02. (See Appendix Table 19 for details on taxable sales activity and the number of sales tax permittees by business type.)

“Business and Personal Service Establishments” had taxable transactions of \$21.7 billion, a decline of 0.3 percent. This category comprises businesses whose income is in large part from nontaxable service and repair labor, and whose tax liability is based mainly on the sale of materials and parts.

“All Other Outlets,” a category made up of businesses whose transactions are mostly nontaxable—manufacturers and wholesalers of all types, construction contractors, petroleum producers, publishers, and a multitude of part-time permittees—reported taxable transactions totaling \$116.8 billion, down 2.4 percent from 2001-02.

Twenty-nine of the 37 types of retail business shown in Appendix Table 19 posted taxable sales increases over the previous fiscal year, while eight showed declines. Service stations had the greatest percentage increase in sales.

2002-03 Taxable Sales

Growth in Actual Dollars Compared to Growth in Constant-Value Dollars

Quarter	Taxable Transactions		Percent Change from Prior Year in		
	Amount	Percent of Total	Actual Dollars	Constant Value Dollars	California Taxable Sales Deflator
July—Sept	\$112,170,185,000	25.0	2.6	3.8	-1.2
Oct—Dec	116,805,211,000	26.1	0.9	1.1	-0.2
Jan—Mar	104,452,613,000	23.3	3.5	2.5	0.9
Apr—June	114,478,198,000	25.6	3.1	3.8	-0.7
Fiscal Year	\$447,906,207,000	100.0	2.5	2.7	-0.2

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Fuel (mostly LPG) and ice dealers experienced the most significant percentage decrease.

Retailers specializing in nondurable goods outperformed stores dealing mainly in durable goods. Sales by retailers specializing in nondurable goods saw their sales increase by 5.1 percent, while stores featuring durable goods had taxable sales growth of 4.3 percent.

Durable goods

New car dealers. New car dealers reported taxable sales growth of 3.9 percent over the prior fiscal year, with taxable transactions totaling \$55.2 billion. The growth in sales was less than in 2001-02, when new car dealers' sales jumped by 11.8 percent over 2000-01.

New vehicle registrations reported by the Department of Motor Vehicles for 2002-03 totaled 2,095,397, a decline of 44,869, or 2.1 percent, from 2001-02. New automobile registrations were down 0.9 percent to 1,710,484. New truck registrations dropped 7.2 percent to 384,913.

Construction and home-related businesses. California's construction industry showed mixed sales results for the fiscal year. Sales for the building material group, which includes

lumber and building material stores, hardware stores, plumbing and electrical supply stores, and paint, glass, and wallpaper stores, grew by 6.6 percent to total \$26.6 billion. However, construction contractors' taxable sales declined by 0.8 percent, totaling \$17.5 billion.

Household and home furnishings stores reported strong growth in taxable transactions while household appliance dealers' sales were flat. Household and home furnishings stores had taxable sales of \$10.2 billion, a jump of 9.8 percent. Household appliance dealers' taxable sales totaled \$4.2 billion, a scant increase of 0.2 percent.

Specialty retailers. The specialty store group includes such retailers as sporting goods, jewelry stores, musical instrument dealers, office and school supply stores, toy stores, bookstores, and a variety of other specialized retailers. These businesses experienced improved sales growth during the fiscal year with taxable sales of \$44.0 billion, up 2.4 percent from 2001-02.

Nondurable goods

Service stations. Service stations' taxable sales increased by 13.8 percent during 2002-03, to

2002-03 New Vehicle Registrations and Taxable Sales of New Car Dealers

Quarter	New Vehicle Registrations						Taxable Sales of New Car Dealers	
	Number	Percent Change Year to Year	Number	Percent Change Year to Year	Number	Percent Change Year to Year	Amount	Percent Change Year to Year
July—Sept	459,178	8.8	106,926	2.7	566,104	7.6	\$14,765,672,000	14.5
Oct—Dec	401,046	-5.2	92,949	-14.4	493,995	-7.0	13,153,143,000	-7.1
Jan—Mar	403,236	-6.3	85,252	-14.9	488,488	-8.0	12,893,922,000	1.6
Apr—Jun	447,024	-0.7	99,786	-2.2	546,810	-1.0	14,409,329,000	7.6
Fiscal Year	1,710,484	-0.9	384,913	-7.2	2,095,397	-2.1	\$55,222,066,000	3.9

2002-03 Taxable Sales of Service Stations Compared to Gasoline Distributions						
Quarter	Taxable Transactions		Gasoline Distributions			
	Amount	Percent Change Year to Year	Gallons	Percent Change Year to Year	Estimated Expenditure	Percent Change Year to Year
July—Sept	\$6,485,876,000	1.3	3,979,984,000	2.5	\$5,950,076,000	–5.0
Oct—Dec	6,095,543,000	15.1	3,869,404,000	5.2	5,796,367,000	21.2
Jan—Mar	6,631,393,000	30.3	3,606,183,000	–3.6	6,209,847,000	30.6
Apr—June	7,013,827,000	12.1	3,938,904,000	0.1	6,932,471,000	16.0
Fiscal Year	\$26,226,639,000	13.8	15,394,475,000	1.0	\$24,888,761,000	14.3

\$26.2 billion. Many service stations are now minimart operations that sell a variety of items, but gasoline remains their main stock in trade. Volatility in gasoline prices can cause extreme quarterly fluctuations in service station sales, which occurred again in 2002-03. While the average price of gasoline increased by 13.2 percent for the full fiscal year, quarterly percent changes in gasoline prices ranged from a 5.0 percent decrease in the third quarter of 2002 to a 30.6 percent increase in the first quarter of 2003. Gasoline consumption increased to 15.4 billion gallons for the fiscal year, a slight increase of 1.0 percent likely constrained by the considerable increase in gas prices.

Other retailers. Other nondurable goods retailers reported sales increases for the fiscal year. General merchandise stores posted taxable sales of \$43.5 billion, an increase of 3.3 percent over 2001-02. Restaurants had taxable sales of \$38.7 billion, an increase of 3.5 percent.

Revenue Growth

Tax and fee programs administered by the Board of Equalization produced state and

local revenues totaling \$41,902,466,000 during fiscal year 2002-03. This was an increase of \$1.4 billion, or 3.5 percent, from 2001-02.

The increased revenue resulted in part from an improving California economy. The increased sales and use tax revenue was also related to a disparity in sales tax rates between fiscal years 2001-02 and 2002-03. In the first half of 2001-02, the state General Fund portion of the statewide sales and use tax rate was 4.75 percent. The rate increased to 5.00 percent on January 1, 2002. The 5.00 percent rate was in effect for all of 2002-03.

Revenues from each tax are presented in the “Comparison of Revenues” table on [page 65](#). Additional detail and historical comparisons are given in Appendix [Table 2](#).

Sales and Use Taxes

Sales and use taxes produce 85 percent of the revenue from Board-administered tax programs. The combination of all state and local sales and use taxes yielded \$35,739,227,000 in 2002-03, an increase of 3.9 percent over 2001-02. The state’s portion of the sales tax grossed \$22,620,217,000. The portion

allocated to other jurisdictions—cities, counties and special districts—totaled \$13,119,010,000, including allocations to the Local Revenue Fund and the Public Safety Fund. (Details are given in Appendix Tables 19 through 23.)

By the end of the fiscal year, special district taxes were being levied by 40 jurisdictions in 27 counties. Businesses in these counties generate 88 percent of all taxable sales in the state. Special tax district information is located in Appendix [Table 21C](#). Total sales and use tax rates by county are found in Appendix [Table 23B](#).

Special Taxes

Fuel taxes. During 2002-03, revenue from the state's fuel taxes totaled \$3,278,867,000, a 1.1 percent increase from 2001-02. Distribution of gasoline for highway use increased 1.0 percent to 15.4 billion gallons. (Historical fuel tax data are presented in Appendix [Tables 24–26](#).)

Alcoholic beverage taxes. Revenue from the state's excise taxes on alcoholic beverages fell slightly from the previous year. Alcoholic beverages, which were taxed at rates ranging from twenty cents per gallon for wine to \$3.30 per gallon for distilled spirits, produced \$290,575,000 in 2002-03, a decrease of 0.7 percent. Revenues from beer and wine decreased to \$150,322,000 and revenues from distilled spirits decreased to \$140,253,000. (See Appendix [Tables 27–29](#) for historical data on taxes, total consumption, and per-capita consumption by major type of beverage.)

Cigarette and tobacco taxes. Revenue from excise taxes on cigarettes and other tobacco

products decreased significantly in 2002-03, dropping 4.1 percent to \$1,064,301,000.

Apparent consumption of cigarettes and tobacco products also declined this fiscal year. (See Appendix [Tables 30A](#) and [30B](#) for additional data regarding these taxes.)

Electricity, telephone, and natural gas surcharges. The electrical energy surcharge, levied on the use of electricity in California, produced revenue of \$46,086,000, a 2.7 percent decrease from 2001-02. Receipts from the emergency telephone users surcharge, used to fund the 911 statewide emergency number system, totaled \$131,239,000, an increase of 4.7 percent. The surcharge for natural gas, which went into effect in January 2001, produced \$227,945,000 for the fiscal year. Additional detail and historical comparisons are provided in Appendix [Table 2](#).

Hazardous substance taxes and other environmental fees. Hazardous substance taxes and other environmental fees yielded 2002-03 revenues of \$404,674,000, a 3.1 percent increase over the prior fiscal year. These taxes and fees fund specific environmental programs.

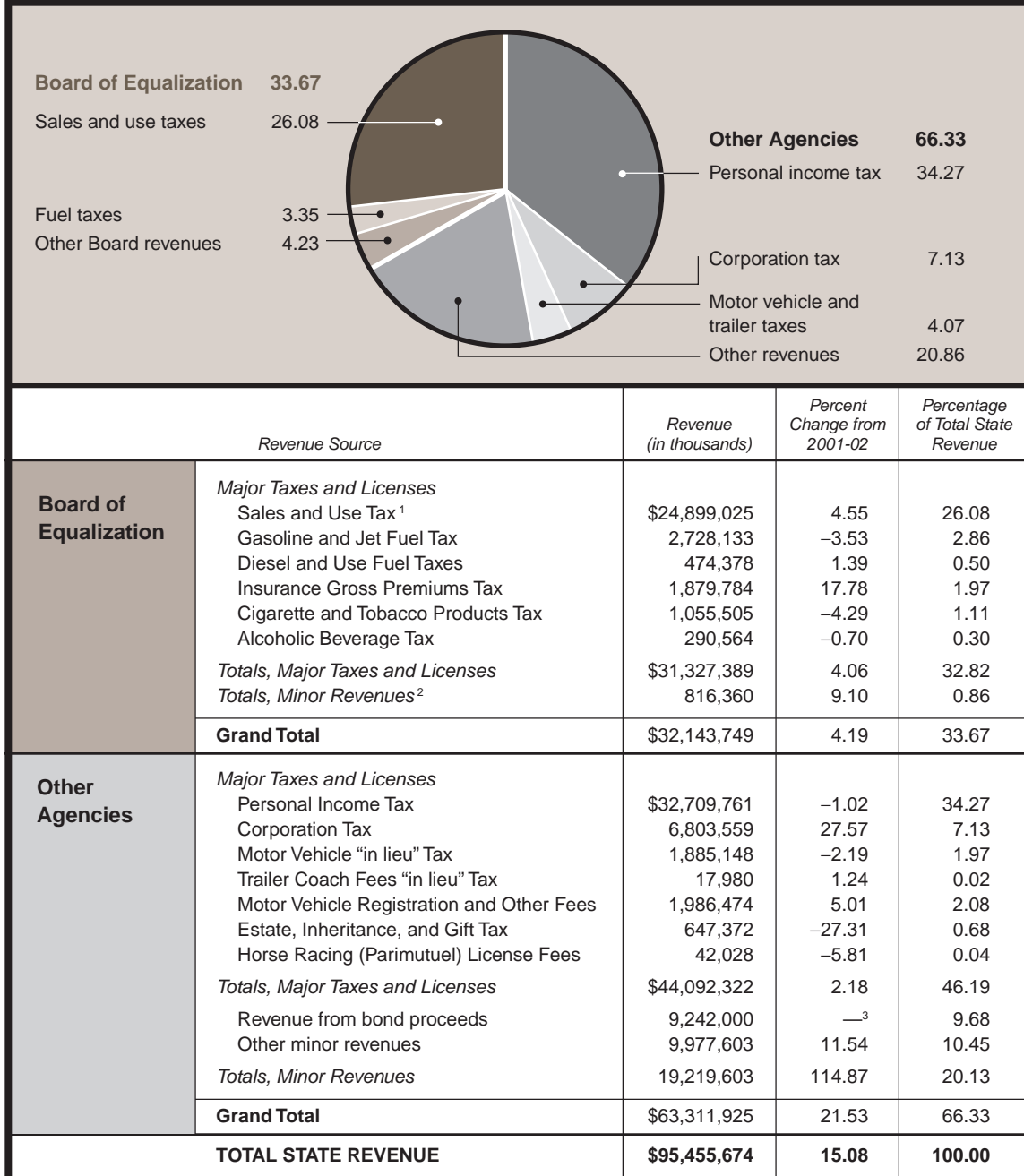
Property Taxes

Locally collected property taxes on state-assessed properties totaled \$700,600,000, an increase of 3.4 percent. The timber yield tax, levied when timber is harvested in lieu of any annual, value-based property tax, continued its downward trend. Receipts totaled \$12,535,000, a 17.0 percent drop from the prior fiscal year. The private railroad car tax, levied on railroad cars owned by firms that do not operate railroads, produced \$6,416,000, a slight increase of 0.6 percent.

Comparison of Revenues 2001-02 and 2002-03*In Thousands of Dollars*

<i>Revenue Source</i>	<i>2001-02</i>	<i>2002-03</i>	<i>Percent Change</i>
Sales and Use Taxes			
State tax ¹	\$21,588,029	\$22,620,217	4.8
Local revenue fund state sales tax (0.50%)	2,208,508	2,279,070	3.2
Public safety fund sales tax (0.50%)	2,208,509	2,279,066	3.2
City and county sales tax (1.00%)	4,423,236	4,527,774	2.4
County transportation tax (0.25%)	1,105,575	1,132,003	2.4
Special district taxes	2,855,851 ^r	2,900,754	1.6
Other taxes and fees	399	341	-14.3
Totals	34,390,107 ^r	35,739,227	3.9
Fuel Taxes and Fees			
Gasoline and jet fuel	2,773,853	2,803,868	1.1
Diesel and use fuel ²	468,295	474,999	1.4
Totals	3,242,148	3,278,867	1.1
Alcoholic Beverage Taxes	292,632	290,575	-0.7
Cigarette and Tobacco Products Taxes			
Cigarette tax	121,611	114,911	-5.5
Cigarette and tobacco products surtax	332,998	322,764	-3.1
Breast cancer research cigarette stamp tax	30,322	31,186	2.8
California children and families first cigarette stamp tax	624,579	595,439	-4.7
Totals	1,109,511	1,064,301	-4.1
Electrical energy surcharge	44,853	46,086	2.7
Natural gas surcharge ³	179,107	227,945	27.3
Emergency telephone users surcharge	125,381	131,239	4.7
Hazardous substances taxes and other environmental fees ⁴	392,535	404,674	3.1
Local taxes on state assessed properties ⁵	677,770	700,600	3.4
Timber yield tax	15,099	12,535	-17.0
Private railroad car tax	6,379	6,416	0.6
GRAND TOTALS	\$40,475,522 ^r	\$41,902,466	3.5

¹ State tax rate 4.75% effective January 2001; 5.00% effective January 2002.² Includes diesel fuel taxes collected under the International Fuel Tax Agreement (IFTA).³ Rates increased by the Public Utilities Commission effective January 1, 2003, to meet projected program costs.⁴ Includes revenues from the hazardous substances tax, integrated waste management fee, underground storage tank maintenance fee, California tire fee, oil spill prevention and administration fee, oil spill response fee, childhood lead poisoning prevention fee, occupational lead poisoning prevention fee, and ballast water management fee.⁵ Collected by county tax collectors.^r Revised

Sources of State Revenue July 1, 2002—June 30, 2003*Percentage of Total State Revenue*

Source: 2004-05 Governor's Budget

¹ Includes revenues from the state sales tax, the state disaster relief tax, and the local revenue fund state sales tax.² Includes private railroad car, electrical energy, natural gas, emergency telephone, and environmental taxes and fees.³ Not computed.

Note: Percentage detail may not compute to totals due to rounding.